UNITED STATES DISTRICT COURT

DISTRICT OF MAINE

VINCENT E. FUREY, et al.,	***)***	
	)	
Plaintiffs	***)***	
	)	
v.	***)***	***Docket No. 01-03-P-C***
	)	
EXECUTIVE RISK INDEMNITY, INC., et al.,	***)***	
	)	
	)	
Defendants	***)***	

RECOMMENDED DECISION ON DEFENDANT ROYAL INDEMNITY COMPANY'S MOTION TO DISMISS

Defendant Royal Indemnity Company ("Royal") moves to dismiss Counts II and III of the complaint in this insurance coverage dispute, to the extent that those counts are asserted against Royal. I recommend that the court grant the motion.

I. Applicable Legal Standard

The motion to dismiss invokes Fed. R. Civ. P. 12(b)(6). Defendant Royal Indemnity Company's Motion to Dismiss Counts II and III pursuant to Fed. R. Civ. Proc. 12(b)(6), etc. ("Motion to Dismiss") (Docket No. 6) at 1. "When evaluating a motion to dismiss under Rule 12(b)(6), [the court] take[s] the well-pleaded facts as they appear in the complaint, extending the plaintiff every reasonable inference in [his] favor." *Pihl v. Massachusetts Dep't of Educ.*, 9 F.3d 184, 187 (1st Cir. 1993). The defendant is entitled to dismissal for failure to state a claim only if "it appears to a certainty that the plaintiff would be unable to recover under any set of facts." *Roma Constr. Co. v.*

aRusso, 96 F.3d 566, 569 (1st Cir. 1996); *see also Tobin v. University of Maine Sys.*, 59 F.Supp.2d 87, 89 (D. Me. 1999).

II. Factual Background

The complaint includes the following relevant factual allegations. The thirteen plaintiffs, residents of Maine, Massachusetts, New Jersey and California, have been named as defendants in an adversary proceeding filed in the United States Bankruptcy Court for the District of Maine entitled *Health Care Accounting & Consulting Servs., LLC v. Directors & Officers of JBI, Viburnum and/or CCSEME,* Docket No. 00-2040, in the consolidated bankruptcy cases entitled *In re Jackson Brook Institute, Inc.* (Case No. 98-20439 JAG) and *In re Viburnum, Inc.* (Case No. 99-20106). Complaint (Docket No. 1) ¶¶ 1, 5. The two defendants are Royal and Executive Risk Indemnity, Inc. ("Executive"), both insurance companies incorporated in Delaware. *Id*. ¶¶ 2-3. The amended complaint in the adversary proceeding seeks to hold the plaintiffs in this action liable for conduct allegedly undertaken in their capacities as directors or officers of Jackson Brook Institute, Inc., Viburnum, Inc., and Community Care Systems of Maine, Inc. *Id*. ¶ 6. The plaintiffs are each incurring legal fees and expenses in defense of the claims asserted in the adversary proceeding. *Id*. ¶ 7.

On or about November 26, 1997 Executive issued a directors, officers and trustees liability insurance policy, policy number 751-085533-97, to Community Care Systems, Inc. of Massachusetts. *Id*. ¶ 8. Jackson Brook Institute, Inc., Viburnum, Inc. and Community Care Systems of Maine, Inc. were then subsidiaries of Community Care Systems, Inc. and each of the plaintiffs was covered by this policy. *Id*. ¶ 9. The policy has a $3,000,000 limit of liability. *Id*. ¶ 8. On or about November 26, 1997 Royal issued an excess directors and officers liability and company reimbursement policy, policy number RHS 606348, to Community Care Systems, Inc. of Massachusetts. *Id*. ¶ 10. This

policy insures the same losses as the Executive policy to the extent that liability exceeds $3,000,000. *Id*. Its limit of liability is $2,000,000. *Id*.

The plaintiffs have provided both defendants with timely notice of the claims asserted in the adversary proceeding. *Id*. ¶ 11. They have satisfied all preconditions to coverage under both policies. *Id*. Both defendants have declined to acknowledge that the plaintiffs are covered for these claims under their respective policies and have not agreed to reimburse the plaintiffs for their fees and expenses incurred in defending against these claims. *Id*. ¶ 12. The plaintiffs contend that one or more of the claims asserted against them in the adversary proceeding are covered by both policies. *Id.* ¶ 13. They claim that the defendants' refusal to acknowledge coverage has had an adverse material effect on their ability to conduct a defense in the adversary proceeding. *Id*. ¶ 14.

The plaintiffs seek a declaratory judgment (Count I) to the effect that the defendants must pay their legal fees and expenses incurred in the adversary proceeding and that one or more of the claims asserted against them in the adversary proceeding is covered by both policies. *Id*. ¶ 16. They allege that the defendants have breached the respective contracts of insurance by refusing to pay their defense expenses on a current basis (Count II) and that the defendants' refusal to acknowledge coverage was made in bad faith (Count III). *Id*. ¶¶ 18-19, 21. The amended complaint in the adversary proceeding, a copy of which is attached to the complaint as Exhibit A, does not specify an amount of damages sought. First Amended Complaint, *In re Jackson Brook Institute, Inc., etc*., Adversary Proceeding No. 00-2040, United States Bankruptcy Court for the District of Maine (Exh. A to Complaint), at 18.

III. Discussion

Royal contends that, as an excess insurer and by the terms of its policy, a copy of which is attached to the complaint as Exhibit C, it has no obligation to pay the plaintiffs' legal expenses in the adversary proceeding unless and until Executive has admitted liability for, or has been held liable to

pay, the full amount of its primary policy coverage, events which have not occurred. Motion to Dismiss at 6. The provisions of its policy relevant to Royal's argument are the following:

> It is expressly agreed that liability for any **loss** shall attach to the Insurer only after the Primary and Underlying Excess Insurers as shown in the Schedule of Underlying Insurance attached, shall have admitted liability for or shall have been held liable to pay the full amount of their respective liability as set forth in said Schedule . . . .
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> * * *
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> This policy is subject to the same warranties, terms, conditions and exclusions (except as regards the premium, the amount and limits of liability and except as otherwise provided herein) as are contained in or as may be added to the policy/ies of the Primary Insurers prior to the happening of a claim which results in a **loss** hereunder.
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> * * *
>
> The Insurer's obligations under this policy shall not be increased, expanded or otherwise modified or changed as a result of the receivership, insolvency, inability or refusal to pay of any Primary or Underlying Excess Insurer. It is agreed that the insurer shall not pay any amount until all retentions and all Primary and Underlying Excess insurance coverages have been paid.

Excess Directors and Officers Liability and Company Reimbursement Coverage, Policy Number RHS 606348 ("Royal policy") (Exh. C to Complaint), §§ II(B) & IV (emphasis in original). The Schedule of Underlying Insurance attached to the Royal policy lists only policy number 751-085533-97 issued by Executive. *Id*. Endorsement #1.

The plaintiffs contend that Massachusetts law applies to this motion, citing *American Employers' Ins. Co. v. DeLorme Publ'g Co.*, 39 F.Supp.2d 64, 72 (D. Me. 1999). Objection to Defendant Royal Indemnity Company's Motion to Dismiss Counts II and III of the Complaint As Against It ("Plaintiffs' Objection") (Docket No. 8) at 5-6. Royal cites both Maine and Massachusetts case law in support of its position, Motion to Dismiss at 8-9, and takes no position on the question of which is applicable, Reply Memorandum of Law in Further Support of Defendant Royal Indemnity Company's Motion to Dismiss, etc. ("Royal Reply Memorandum") (Docket No. 13) at 6-7. Because

Maine and Massachusetts law do not differ on the relevant legal issues, it is unnecessary to resolve this question at this time. I will refer to case law from both jurisdictions.

The Maine Law Court has not specifically addressed the issue presented by the motion to dismiss but has indicated in general terms that excess insurance is not applicable until primary insurance has been exhausted. *See Cobb v. Allstate Ins. Co.*, 663 A.2d 38, 40 (Me. 1995) ("Because Allstate's policy is excess, it has no applicability at all until the primary coverage is exhausted."); *Globe Indem. Co. v. Jordan*, 634 A.2d 1279, 1284 (Me. 1993) ("Cases applying the rule that an excess insurer owes no obligation to contribute to defense costs until and unless the primary coverage is completely exhausted, generally involve truly excess, umbrella policies, or policies in which the language clearly provides that no defense would begin until the underlying insurance was exhausted."). The Massachusetts Supreme Judicial Court has held that excess insurance benefits do not "drop down" to fill a void in underlying insurance created by the insolvency of the underlying carrier. *Massachusetts Bay Transp. Auth. v. Allianz Ins. Co.*, 597 N.E.2d 439, 477, 478-79 (Mass. 1992). A Massachusetts Superior Court justice has held that "[w]hile the primary insurer is responsible to indemnify and pay defense costs, the excess insurer is simply obligated to indemnify the insured for amounts recovered in excess of the primary insurer's policy limits." *United Techs. Corp. v. Liberty Mut. Ins. Co.*, 1 Mass.L.Rptr. 91, __, 1993 WL 818913 (Mass. Super. Aug. 3, 1993), at *15 & *16.

The majority rule in other states that have considered the question presented here is that excess or umbrella carriers are responsible for defense costs only after exhaustion of the primary policy limits. *Molina v. United States Fire Ins. Co.*, 574 F.2d 1176, 1178 (4th Cir. 1978); *Texas Employers Ins. Ass'n v. Underwriting Members of Lloyds*, 836 F. Supp. 398, 407 (S.D. Tex. 1993) (citing cases); *Keck, Mahin & Cate v. National Union Fire Ins. Co. of Pittsburgh*, 20 S.W.3d 692, 700 (Tex. 2000) (same). *See also, e.g., Bettenburg v. Employers Liab. Assurance Corp.*, 350 F. Supp.

873, 878 (D. Minn. 1972) (Minnesota law); *Colorado Farm Bureau Mut. Ins. Co. v. North Am. Reinsurance Corp*., 802 P.2d 1196, 1198 (Colo. App. 1990); *United States Fire Ins. Co. v. Roberts & Schaefer Co.*, 683 P.2d 600, 603-04 (Wash. App. 1984); *Signal Cos. v. Harbor Ins. Co.*, 612 P.2d 889, 894-95 (Cal. 1980).

The plaintiffs contend that the general rule is not applicable in this case for three reasons. First, they rely on the language of the Royal policy quoted above which states that the policy is subject to the same terms and conditions as the underlying primary policy. Plaintiffs' Objection at 3-4, 6-7. They point to the following language in the primary policy issued by Executive:

> The Underwriter shall, upon written request by an **Insured**, pay on a current basis **Defense Expenses** which are otherwise payable under this Policy, except to the extent that such **Defense Expenses** are being paid under the terms of any other policy or policies of insurance.

Directors, Officers and Trustees Liability Insurance Including Healthcare Organization Reimbursement Policy, Policy No. 751-085533-97 ("Executive policy") (Exh. B to Complaint) § IV(A)(2) (emphasis in original). However, the language of the Royal policy provides that the assumption of the terms and conditions of the underlying primary insurance policy is made "except as otherwise provided herein," Royal Policy § IV, and the Royal policy otherwise provides that no liability attaches unless and until the primary insurer has admitted liability or been found liable to pay the full amount of its policy, an event that the plaintiffs do not allege has occurred.

The plaintiffs' second argument is that by relying on the language of the Royal policy to which I have just referred, Royal "has merely presented an argument that the insurance contract is ambiguous," Plaintiffs' Objection at 7, and that because ambiguous terms in an insurance contract must be construed against the insurer, *id*. at 6, Royal cannot prevail under the Rule 12(b)(6) test for dismissal. The plaintiffs do not specify how Royal's argument is based on an ambiguity in the policy

language, and no such assertion is apparent to me in Royal's submissions to the court. Nor does the policy language itself appear in any way ambiguous.

The plaintiffs' final argument relies on case law in which courts have held that "where there is the prospect that an excess insurer may have to pay some of the claim, that insurer may be responsible for at least a portion of the defense costs." *Id*. at 8. In *Belmer v. Nationwide Mut. Ins. Co.*, 157 Misc.2d 845, 599 N.Y.S.2d 427 (N.Y. Sup. Ct. 1993), upon which the plaintiffs rely, the court did state that it "[held] that the primary insurer had the initial duty of defense until it appeared that the excess carrier would have to contribute to the judgment," 157 Misc.2d at 852-53, although the case actually involved coincidental mutual coverage, not primary and excess coverage, *id*. at 848-49. At least one court has specifically rejected this gloss on the majority rule. *Fireman's Fund Ins. Co. v. Rairigh*, 475 A.2d 509, 517-18 (Md. Spec. App. 1984). In any event, even the case law cited by the plaintiffs requires a showing that the amount of the claims for which coverage is sought falls outside the limits of the primary policy. *Schulman Inv. Co. v. Olin Corp.*, 514 F. Supp. 572, 577 (S.D. N.Y. 1981). *See also Hartford Accident & Indem. Co. v. United States Fire Ins. Co.*, 710 F. Supp. 164, 167 (E.D. N.C. 1989). Here, the complaint is devoid of any allegation suggesting that the Executive policy limits will be exceeded by the total value of the claims in the adversary proceeding. The plaintiffs' assertion that "given the number and seriously [sic] of the allegations made against the thirteen plaintiffs, it can be reasonably inferred (and, indeed, Plaintiffs are presently able to demonstrate) that the plaintiffs in the adversary proceeding are seeking in excess of $3 million in damages," Plaintiff's Objection at 9, is not sufficient to remedy the omission of such a critical allegation from their complaint. First, while the plaintiffs may have a "present ability" to demonstrate the amount sought in the adversary proceeding, they have made absolutely no effect to do so. More important, an inference that the claims asserted in the adversary proceeding would aggregate in excess

of $3 million in damages, even with the necessary and, at this point, unreasonable assumption that all of the claims are in fact covered by the Executive policy, is not and cannot be reasonable based on the complaint in that action alone, which is the only basis offered for this conclusion by the plaintiffs.

Accordingly, Royal's motion to dismiss Counts II and III should be granted. However, Royal's request that the dismissal be with prejudice, Motion to Dismiss at 15, overreaches. It is a necessary corollary of Royal's argument that the limits of Executive's primary policy may in fact at some future date be exhausted, at which time Royal's excess policy may or may not come into play. The fact that the plaintiffs sought payment of their defense costs by Royal prematurely in this action should not serve to bar them from seeking such relief at an appropriate time in the future. Royal has cited no authority in support of its request and it is not entitled to dismissal with prejudice.

IV. Conclusion

For the foregoing reasons, I recommend that the motion of defendant Royal Indemnity Company to dismiss Counts II and III be **GRANTED** without prejudice.

NOTICE

A party may file objections to those specified portions of a magistrate judge's report or proposed findings or recommended decisions entered pursuant to 28 U.S.C. § 636(b)(1)(B) for which de novo review by the district court is sought, together with a supporting memorandum, within ten (10) days after being served with a copy thereof. A responsive memorandum shall be filed within ten (10) days after the filing of the objection.

Failure to file a timely objection shall constitute a waiver of the right to de novo review by the district court and to appeal the district court's order.

Dated this 13th day of June, 2001.

David M. Cohen
United States Magistrate Judge

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